# NOTES

## WASHINGTON NOTES

### THE NEW RESERVE DISTRICTS

The first step in providing for the definite establishment of the new banking and currency system has been taken by the Organization Committee created under the law of December 23, 1913. This committee announced on April 3 the outline of the reserve districts that have been determined upon as a result of a series of hearings held throughout the country during the past few weeks, and the subsequent deliberations thereon. In brief, the plan now announced provides for the establishment of 12 districts, the maximum number permitted under the law, and will result in dividing the country into districts whose characteristics would be practically as shown in the table on p. 483.

The principles upon which the division has been made are set forth only in very general terms, the committee stating them in part thus:

Among the many factors which governed the committee in determining the respective districts and the selection of the cities which have been chosen were:

First, the ability of the member banks within the district to provide the minimum capital of $4,000,000 required for the Federal reserve bank on the basis of 6 per cent of the capital stock and surplus of member banks within the district.

Second, the mercantile, industrial and financial connections existing in each district and the relations between the various portions of the district and the city selected for the location of the Federal reserve bank.

Third, the probable ability of the Federal reserve bank in each district, after organization and after the provisions of the Federal reserve act shall have gone into effect, to meet the legitimate demands of business, whether normal or abnormal, in accordance with the spirit and provisions of the Federal reserve act.

Fourth, the fair and equitable division of the available capital for the Federal reserve banks among the districts created.

Fifth, the general geographical situation of the district; transportation lines, and the facilities for speedy communication between the Federal reserve bank and all portions of the district.

Sixth, the population, area, and prevalent business activities of the district,

NATIONAL BANKS, MARCH 4, 1914

| District No. | Reserve City | Area in Sq. Miles | Population | No. of Banks | Capital and Surplus | 6 Per Cent Subscription | Including State Banks and Trust Companies That Have Applied for Membership up to April 1, 1914 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | No. of Banks | Capital and Surplus | 6 Per Cent Subscription |
| 1 | Boston........ | 66,465 | 6,557,841 | 446 | $165,529,010 | $ 9,931,740 | 446 | $165,529,010 | $ 9,931,740 |
| 2 | New York..... | 49,170 | 9,113,279 | 478 | 343,693,437 | 20,621,606 | 479 | 344,793,437 | 20,687,616 |
| 3 | Philadelphia ... | 39,865 | 8,110,217 | 800 | 216,340,213 | 12,980,412 | 801 | 216,550,213 | 12,993,013 |
| 4 | Cleveland ..... | 183,995 | 7,961,022 | 724 | 192,147,258 | 11,528,835 | 726 | 193,697,258 | 11,621,835 |
| 5 | Richmond..... | 173,818 | 8,519,313 | 475 | 105,064,483 | 6,303,869 | 484 | 109,054,683 | 6,543,281 |
| 6 | Atlanta....... | 233,860 | 6,695,341 | 372 | 77,356,913 | 4,641,415 | 382 | 78,379,663 | 4,702,780 |
| 7 | Chicago....... | 176,940 | 12,630,383 | 984 | 211,068,338 | 12,664,100 | 999 | 219,198,760 | 13,151,925 |
| 8 | St. Louis...... | 146,474 | 6,726,611 | 434 | 80,717,981 | 4,843,079 | 445 | 103,655,397 | 6,219,323 |
| 9 | Minneapolis ... | 437,930 | 5,724,893 | 687 | 78,381,081 | 4,702,864 | 687 | 78,381,081 | 4,702,864 |
| 10 | Kansas City ... | 509,649 | 6,306,850 | 835 | 93,065,912 | 5,583,955 | 838 | 93,248,612 | 5,594,916 |
| 11 | Dallas........ | 404,826 | 5,310,561 | 726 | 92,003,123 | 5,520,187 | 732 | 93,901,523 | 5,634,091 |
| 12 | San Francisco.. | 693,658 | 5,389,303 | 514 | 130,423,422 | 7,825,405 | 529 | 135,258,732 | 8,115,524 |
| | Total....... | 3,016,650 | 89,045,616 | 7,475 | $1,785,791,171 | $107,147,470 | 7,548 | $1,831,648,369 | $109,898,902 |

whether agricultural, manufacturing, mining, or commercial; its record of growth and development in the past and its prospects for the future.

In determining the several districts, the committee has endeavored to follow state lines as closely as practicable and whenever it has been found necessary to deviate, the division has been along lines which are believed to be most convenient and advantageous for the district affected.

The plan of division indicated by the committee has already received very severe criticism, this criticism being particularly addressed to the following points:

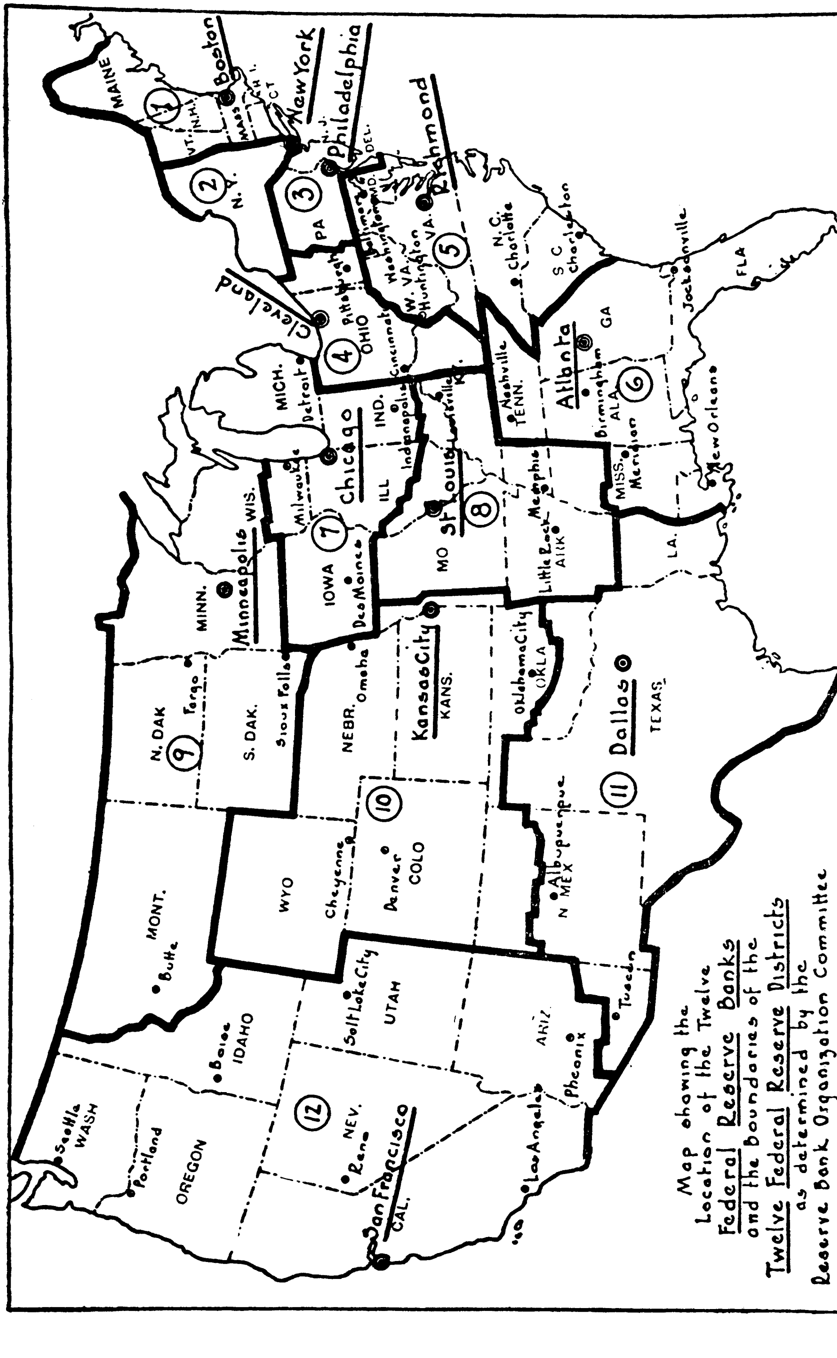
1. The establishment of the maximum number of 12 districts, notwithstanding that the advice of a large number of bankers and business men had been in favor of the limitation of the number to the minimum required by law.

2. The failure to create a single large overshadowing bank with a capital of not less than $25,000,000 to $30,000,000, such a bank having been strongly recommended on the ground that an institution of such a size was necessary to control foreign exchange operations and to direct the course of trade and monetary operations between the United States and foreign countries.

3. The placing of too many districts on the Atlantic Coast while the West was left relatively unsupplied with districts and banks.

4. The faulty division of the country between the several districts in certain particulars. Among these particulars are expressly mentioned (*a*) the selection of boundary lines that would include larger and richer centers as tributary to smaller and weaker points at which reserve banks were situated, (*b*) the artificial separation of certain portions naturally tributary to a given city and their inclusion in a region assigned to another city, (*c*) the erroneous assignment of certain regions to cities with which they have comparatively poor or slow transportation connections.

These objections, as thus classified, practically summarize the whole case against the plan of districting, but there is a distinct difference in the weight to be given to the various criticisms. As to whether the maximum or minimum number of districts should have been created, decided difference of opinion undoubtedly exists in responsible circles, not a few persons taking the view that if possible the 12 districts should have been mapped out, assuming of course that each could be assigned a capital adequate to the creation of a reasonably strong bank in the district under consideration. This point may be regarded therefore as essentially a question of difference in theory or of attitude toward the banking organization question in general.




OFFICIAL MAP; ISSUED APRIL 3, 1914

In the same way the failure or refusal to create a single bank of predominant capital is not considered as affording ground for the pessimistic criticisms that are voiced in some quarters. The New York reserve bank actually provided for will have a much larger capital than any other institution in the system, and, while its capital is materially smaller than the combined capital and surplus of several of the other institutions located in the city of New York, this fact is not regarded as necessarily indicating anything very definite with reference to the effectiveness of the proposed plan. As a matter of fact, the Bank of England is considerably below several other institutions in London, so far as relates to aggregate resources. This does not prevent the Bank of England from exercising a predominant control over the prevailing rate of discount. A similar condition exists in some of the continental countries. It is believed, therefore, that the size allowed to the New York institution is amply sufficient to permit of the establishment of an effective bank. Moreover, too little weight appears to have been allowed in current discussion to the fact that the Federal Reserve Board will exercise a powerful central control over the whole system and will undoubtedly succeed in uniting the different institutions in a single and well-considered national policy.

A different point of view is evidently entertained by careful thinkers with respect to the actual districting. The third point already mentioned above—that too many districts have been placed on the Atlantic Coast while the West is left relatively unsupplied—is regarded as having very considerable force. As things stand, the Atlantic Coast districts are represented by the cities of Boston, New York, Philadelphia, Richmond, and Atlanta. This is considered clearly one too many, the unnecessary city and district being Richmond. By leaving out the Richmond district, a much-needed district which could have been used elsewhere would have been saved with positive benefit to the other districts on the Atlantic Coast which are now too thickly packed together to admit of a healthy growth. The belief prevailing in sound quarters is that the Atlanta district with its very limited capital would have been better off had not the states of North and South Carolina, which properly belong to it, been pared away in order to provide a southern extension for the Richmond district. In the same way, the northward extension of the Richmond district tended to force the northern boundary of the Philadelphia district to the shores of New York harbor, thereby depriving New York City of a portion of its natural territory—the northern rim of New Jersey—while in like manner the rearrangement of boundaries

necessitated by the insertion of the Richmond district tended to prevent the inclusion of western Connecticut with New York, and to force other adjustments generally believed to be out of harmony with the "convenience and customary course of business."

In a somewhat similar fashion, the fourth criticism already mentioned is finding support among informed students of banking. This criticism closely follows that which has been last considered. By making Baltimore, for example, tributary to Richmond, and New Orleans to Atlanta, an injury was done not only to local pride but also to the convenient and customary development of trade relations. The work done in this regard seems to make it unavoidable that there should be a considerable reversal of the current of business in a number of districts, the clearing of checks and the obtaining of rediscounts being carried on at points where under other conditions they would never have been placed. Undoubtedly this kind of change will cause some friction, but there seems to be little doubt that the amount of it has been considerably exaggerated. Those who are disposed to place too much stress upon the effect of the districting overlook the fact that the new system is simply superadded to existing banking arrangements and that it in no way interferes with them. Even the redistribution of reserves does not affect them, since the gross amount of required reserve is so reduced under the new banking act that banks which have been in the habit of keeping reserve balances with the old reserve cities could continue to do so without serious hardship under the new law, even if these balances were not counted as reserves. They would be as well off as they were before. The criticism of the districting really amounts in the last analysis to a statement that the work has not been done as well as it might have been, and that if it had been more carefully performed the operation of the new system would have been somewhat smoother and easier to manage.

There is general agreement that, irrespective of the districting—but the more important because of the way in which this districting has been done—a fundamentally important influence will be exerted upon the new system by the plan that is mapped out for clearing and for the relationship between branch offices and reserve banks. If the reserve banks establish branches with a fair degree of freedom at points where they are most needed, and if these branches are permitted to transmit their items for clearance direct to the head offices of the other reserve districts, it is believed that the location of the reserve banks, which are

said to have been placed without due care and consideration, will not be a matter of fundamental importance. Such a plan will, therefore, be of primary significance and will have to be announced early if it is to go into actual effect upon the organization of the system. It is a notable fact that the Organization Committee did not in its announcement make any statement about the location of branches. It evidently, and perhaps wisely, felt that in leaving this matter to be attended to by the several banks themselves it accomplished all that could be done in the direction of offsetting any friction or irritation that might be felt in consequence of the methods employed in districting. The reserve banks will be able to locate their own branches, and it may easily be that in certain of the districts the branches will be more important than the head offices in the volume of their transactions. This would be an anomalous condition, but one which would perhaps result in no serious harm. At all events, it seems likely to be the direction in which actual development will go on. The next step in the organization of the system, the naming of the Federal Reserve Board, will probably be taken before even any tentative announcements are made with respect to the organization of the individual banks. The Board will then be in a position to direct the details of the organization in each district, and to appoint the respresentatives of the government, including the Federal reserve agent and his deputy, in each region.

## RAILWAY CAPITAL COSTS

The Interstate Commerce Commission has now practically finished its hearings with reference to the proposed railroad rate increase; and while it will probably receive some further argument on the general question of costs of capital and conditions under which railroad securities are sold, it will, according to expectations, make these hearings largely *pro forma*, so that the case of the railroads may be said to be, to all intents and purposes, already in hand. The feature of the work of the past month has been the filing of evidence with the Interstate Commerce Commission regarding the actual conditions under which the railroads today find themselves compelled to get the funds they require. Very careful inquiries have been made into the recent changes in the yield of railroad securities, that is to say, in the rate that new bonds must bear in order to induce buyers to take them up. The data thus filed seem to make it certain that the average rate of yield on new issues of railroad securities during the past ten years has advanced about one-fourth, that is to say, if the average yield was 4 per cent ten years ago it is 5 per cent today

with reference to a supposed standard bond selling at an assumed stable figure. This fact, established by much detailed evidence, leads to interesting conclusions. As the average amount annually expended by the roads during the past six years for additions and betterments has been about $600,000,000, it is plain that in order to earn 4.10 per cent (the average yield of selected railroad bonds in 1903) the year 1911 would require additional gross receipts over and above those obtained of $78,544,061, it being assumed that the operating ratio was 68.68 per cent as shown by the figures for that year. Of course this computation is based upon the assumption that the roads can issue bonds based on first mortgages for the whole volume of new capital required and can sell them at prices equivalent to those realized ten years ago. Granting, however, that this assumption is taken as correct, the payment of an extra 1 per cent on $600,000,000, the annual new capital required, would necessitate $19,157,088 in additional gross revenue. In order to get this on the ton-mile basis of 7.54 mills it would be necessary to add 2,540,727,867 ton-miles of freight. This, however, could not be done without adding large new facilities which cannot be had under existing earning conditions.

In addition to this situation as to capital, there must be considered, as has now been made plain in the testimony before the Commission, the fact that the economies instituted by railroads during the past few years and the increased traffic resulting therefrom have not been sufficient to offset the increased cost of wages, materials, supplies, and taxes, so that although there has been a very large increase in fixed charges the railroads have had less money available with which to meet such charges. This showing seems to indicate in the most positive manner the conclusion that, despite a most urgent need for capital wherewith to make up in efficiency losses that have occurred through the reduction of what can be accomplished through the use of funds for wages, materials, and the like, there is no means of obtaining such additional capital except by proving to the investor that the railroads are able to meet his demands as to greater security through the earning of much larger net sums. This argument has been most effectively presented in the data filed with the Commission by Vice-President W. H. Williams of the Delaware & Hudson Co., who has made one of the most careful studies of the situation as to railway credit and increased competition for capital that has as yet been presented to the Interstate Commerce Commission. Mr. Williams in his analysis reaches the conclusion that:

1. There has been a general increase in the interest return demanded of investment securities and at the same time the railroads have been forced to

meet growing competition in the investment field from the so-called public utility and industrial enterprises which are able to offer the higher rates of interest, and from governmental sources which have increased their demands for capital and have raised their tax rates in order to make their demands effective.

2. The ability of the railroads to secure new capital has been impaired by the reduction in the factor of safety. Investors have noted the increased proportion of the total financing depending upon bond issues, and the failure of the additional capital invested during recent years to earn any or an adequate return.

Probably the argument before the Commission with reference to the conditions in the matter of railroad capital requirements has never before been so effectively represented as it has in this case, and the fact is fully recognized both by members of the Commission and by the so-called members of Congress. That is shown in the outburst of criticism on the floor of the Senate, originating with Senators La Follette and Cummins, the two most extreme anti-railroad men in the so-called "Progressive" wing of that body. Their arguments, offered in formal speeches, have been intended to show statistically and otherwise the facts as to the great increase in railroad incomes during the past ten or fifteen years. With this general showing no one, of course, is disposed to quarrel, the chief comment being that such arguments fail to consider the increased costs of operation and of capital which have much more than offset the growth in revenue during the period in question.

## THE RURAL CREDIT BILL

Congress has definitely taken up the task of preparing a rural credit bill as a complement to the Federal Reserve act passed last December. The work has been intrusted to a joint subcommittee of the Senate and House which has been laboring upon the preliminary draft of a measure intended to provide a satisfactory means for the extension of loans to farmers. It is expected that the new bill will be indorsed by the administration and introduced into both houses at a very early date. The chief features of the measure are expected to be about as follows: After providing for the establishment of local institutions organized to extend loans secured by a first lien on farm lands, the measure will authorize the establishment of banking institutions empowered to issue bonds representing the local first mortgages taken over from the institutions which originally made them. These bonds may be sold to investors or may be turned over to the local institutions themselves in payment for the

mortgages, or may be disposed of in both ways; but in any event the plan will be to obtain fresh capital for further loans upon real estate by ultimately getting the bonds into the hands of investors who will hold them and in return furnish the funds necessary for the farm loans. Amortization payments will enable the makers of the mortgages to cancel their indebtedness in the course of a fixed term of years by paying in at stated intervals a specified percentage upon the amount of the face of the loan. A general supervisory board, or government mechanism of some kind, will be created to furnish the proper oversight and insure the legitimate management of the bond and mortgage exchanges. It is recognized that the success of the plan will depend fundamentally upon a conservative and appropriate appraisal of the lands upon which the securities are based and that such an appraisal cannot be satisfactorily made except under the most minute supervision and control in order that the possibilities of danger in overestimate may be kept down to the narrowest minimum consistent with the proper working of the system. Such appraisals if correctly carried out will, it is expected, avoid the danger of a real estate expansion that would raise values and threaten the soundness of the system as a whole. It is believed, however, that other safeguards, prominent among them the limitation of the purposes for which loans can be made, must be carefully applied. These purposes, it is thought, should include only the improvement of the land on the security of which the loan is contracted, although some would permit the making of loans to a certain extent for the purpose of paying off a portion of the purchase money required in the acquisition of farm lands. Further than this, proper provision for reserves against loss and suitable protection in cases where default has occurred are likewise to be called for. The prospects of passing such a rural credit bill at the current session of Congress had been accounted good up to the time that the hostilities with Mexico became acute. Such a measure is urgently desired by members of Congress who have agricultural constituencies, and the President had quite definitely committed himself to some such plan last year, when the general banking and currency act was under consideration. The Mexican situation may in this case, as in many others, limit the possibilities of progress and may consequently prevent the adoption of a bill by both houses before adjournment. That a rural credit measure framed on these lines will, however, be approved and passed by Congress before the expiration of many months is now generally conceded.